

**STATE OF WASHINGTON  
STATE INVESTMENT BOARD**

Public Markets Committee Meeting  
Minutes

February 7, 2006

The Public Markets Committee met in open public session at 1:03 p.m. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present: Glenn Gorton  
Charlie Kaminski  
John Magnuson  
Robert Nakahara (via teleconference)  
David Nierenberg  
Dave Scott  
Gary Weeks

Members Absent: Pat McElligott  
Representative Sommers

Other Board  
Members Present: George Masten

Others Present: Joe Dear, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Liz Mendizabal, Public Affairs Director  
Nancy Calkins, Senior Investment Officer – Public Equity  
Diana Will, Senior Investment Officer – Asset Allocation  
Bill Kennett, Senior Investment Officer – Fixed Income  
Kristi Bromley, Administrative Assistant – Investments  
Paul Silver, Assistant Attorney General

Janet Becker Wold, Callan Associates  
James Donald, Lazard Asset Management  
Tom Franzese, Lazard Asset Management  
Joel Damon, J.P. Morgan Asset Management  
Leila Gastil, J.P. Morgan Asset Management  
Luke Richdale, J.P. Morgan Asset Management  
Stephen Burrows, Pictet Asset Management  
John Maratta, Pictet Asset Management

[Names of other individuals attending the meeting are not included in the minutes but are listed in the permanent record.]

The meeting convened at 1:03 p.m. with Chair Gorton identifying members present.

**ACTIVE GLOBAL EMERGING MARKETS INVESTMENT MANAGEMENT INTERVIEWS**

Mr. Bruebaker noted the Board's recent asset allocation decision, which increased the international equity allocation for the defined benefit Commingled Trust Fund from 15 percent to 23 percent. During November 2005, staff transitioned \$2.5 billion into international equities to implement the majority of the change in asset allocation. At December 31, 2005, the WSIB's two continuing emerging markets managers held \$437 million in assets, below the \$819 million needed to meet the emerging markets target of 7 percent within the total international equity allocation.

Callan Associates was selected to assist in the search for additional emerging markets managers that had capacity and were open to new investors. Callan reviewed 168 emerging markets products and, through various screening processes approved by WSIB staff, brought the universe down to 14 for further evaluation by the Callan Manager Search Committee and WSIB staff, which resulted in further narrowing of the universe to ten firms. WSIB staff scored and ranked the ten candidates and interviewed the top five by video conference and brought the top three firms to the Public Markets Committee for consideration. Mr. Bruebaker recommended that all three firms be hired and funded with approximately \$127 million each.

***Lazard Asset Management***

Mr. Franzese introduced himself and Mr. Donald and highlighted Lazard's bottom-up relative value stock picking, philosophy, portfolio construction, dedicated emerging markets team, global research platform, risk control processes with focus on accounting validation, and firm-wide resources. Mr. Donald reviewed the emerging markets team and decision making process. He discussed Lazard's industry focus, interaction with global research platform, and bottom-up consideration of macroeconomic and political factors. He reviewed Lazard's investment process, including analytical framework, accounting validation, fundamental analysis, and portfolio construction.

Mr. Franzese reviewed performance information and geographic and sector diversification.

Discussion ensued regarding Lazard's forward looking forecasts, effects of 1999 bubble on emerging markets, outlook for emerging markets, portfolio construction, and investment parameters.

***J.P. Morgan Asset Management***

Mr. Damon, Mr. Richdale, and Ms. Gastil introduced themselves. Mr. Damon and Ms. Gastil provided an overview of their presentation highlighting the focused strategy, process, performance, portfolio fit, research, stability, and investment vehicles for J.P. Morgan's global emerging markets equities.

Ms. Gastil reviewed J.P. Morgan's investment philosophy, including focus on country factors rather than sector factors and importance of strong, local presence. She reviewed history of

emerging markets investing at J.P. Morgan, bottom-up portfolio design, and multi-source idea generation process with research from country specialists, macro analysts, and global portfolio managers. Ms. Gastil discussed the stock selection process, focus on structural quality of companies, and expected relative return.

Mr. Richdale reviewed the portfolio design, including concentration, long-term approach, and stock-level decisions, and provided an example of their stock selection process, noting the portfolio's high quality holdings and growth bias.

Discussion ensued regarding departures in the firm, sustainability of emerging markets performance, portfolio construction process, and investment parameters.

***Pictet Asset Management***

Mr. Maratta introduced himself and Mr. Burrows and reviewed Pictet's investment philosophy of bottom-up, core manager with value bias, definition of value with focus on replacement costs of productive assets, and internal research function with proprietary database. He reviewed Pictet's investment process, with quantitative screening, fundamental analysis, and risk overlay.

Mr. Burrows reviewed the emerging markets team, noting depth of research capability, stock selection experience, and decision-making process. He reviewed Pictet's stock selection process and provided an example including the value calculation and its impact on early warning signs. Mr. Burrows also reviewed the fundamental analysis, macroeconomic risk control, sell discipline, and decision-making process.

Mr. Maretta noted the increased emphasis on risk control. Mr. Burrows reviewed the portfolio statistics and characteristics as well as portfolio construction.

Discussion ensued regarding Pictet's differentiated valuation approach, risk analytics system, distinguishing characteristics, and reasons for staff turnover.

**REVIEW AND APPROVAL OF MINUTES – SEPTEMBER 12-13, 2005 AND NOVEMBER 1, 2005**

**Mr. Scott moved to adopt the September 12-13 and November 1, 2005 Public Markets Committee minutes. Mr. Weeks seconded and the motion carried unanimously.**

[The Committee recessed at 3:10 p.m. and reconvened at 3:26 p.m.]

**ACTIVE GLOBAL EMERGING MARKETS INVESTMENT MANAGEMENT INTERVIEWS – CONTINUED**

Mr. Bruebaker reiterated that staff recommends hiring all three managers and funding them with approximately \$127 million each. Discussion ensued regarding selection process, stock duplication among managers, and views on the three firms interviewed, including performance, emerging markets teams, and investment approaches.

**Mr. Scott moved that the Public Markets Committee recommend that the Board select Lazard Asset Management, J.P. Morgan Asset Management, and Pictet Asset Management as the apparently successful offerors for the Active Global Emerging Markets Investment Management mandate, subject to continued due diligence and successful negotiation of terms and conditions. Mr. Weeks seconded, and the motion carried unanimously.**

Further discussion ensued regarding the performance of and allocations to the WSIB's continuing emerging markets managers.

### **FIXED INCOME ANNUAL PORTFOLIO REVIEW**

Mr. Kennett introduced himself and provided a 2005 market review, including interest rate tightening, GDP growth, employment statistics, inflation rates, trade deficit, and yield curve flattening. He noted that the yield curve has inverted a couple of times since the end of 2005, which may be an indicator of recession.

Mr. Kennett reviewed the 10-year treasury yield, which continues at low historical levels, and the 10-year credit spreads, noting the historically tight spreads which are due in part to credit fundamentals being better than they have been in a long time. He also reviewed the interest rate changes and returns for Treasuries and the Lehman Aggregate and Lehman Universal indices. Mr. Kennett provided a market outlook for 2006, noting the uncertainty and complacency in the markets as well as small risk premiums.

Mr. Kennett reviewed the overriding portfolio strategy to remain defensive and maintain short to neutral durations and TIPS exposure, add to mortgage holdings, continue to underweight domestic high yield, and stay selective in credits. If market conditions change, he expects to extend durations, add to high yield and investment grade credits, and swap from pass-through mortgages to CMOs. He reviewed the market value of the fixed income portfolios, which totaled \$22.9 billion as of December 31, 2005, sector allocations, and trading activity across all funds.

Mr. Kennett reviewed the goals, performance, and fund statistics for each of the various fixed income portfolios: Retirement Fund, Labor and Industries' Funds, Permanent Funds, Intermediate Bond Fund, Savings Pool, and Guaranteed Education and Developmental Disabilities Endowment Fund TIPS.

### **HORIZON FUNDS ANNUAL PORTFOLIO REVIEW**

Ms. Will introduced herself and presented the WSIB Horizon Funds Annual Report. The Horizon Funds are comprised of three different funds with three distinct levels of risk and return and are composed of varying percentages of four asset classes: cash; fixed income; U.S. equity; and international equity. She reviewed the target asset allocations for each of the three Horizon Funds, provided a history of the funds, and reviewed growth of assets since inception. Ms. Will noted participant distribution and percentage of plan assets.

Ms. Will reviewed total return and performance attribution for each fund, noting that the funds show improved performance and are outperforming their benchmarks over the 1-year period. She reviewed the performance of the underlying managers.

Discussion ensued regarding cash management and the improved performance seen since implementing trading restrictions in the international equity component of the Horizon Funds.

**OTHER ITEMS**

There being no further business to come before the Public Markets Committee, the meeting adjourned at 4:41 p.m.